ECO Consultation

Briefing Note on Government Proposals

March 2014

Summary

On March 5th 2014 during his Ecobuild Keynote address, Secretary of State Ed Davey announced the ECO and Green Deal consultation which formally outlines proposed changes to the schemes which were originally announced in December 2013 following a "Green Levies Review". Industry has until the 16th April 2014 to respond to the 64 questions of the Consultation.

While Ed Davey said that "the ambition for the new policy framework remains unchanged… as at [the scheme] launch" it is clear that there will be significant changes to ECO in particular. The stated intention of the changes is to make ECO more "cost effective". The changes made to ECO will in many cases retroactively apply to the 2013-2015 phases of the scheme, and then be continued into the 2015-2017scheme.

DECC released an initial update to the 2012 Impact Assessment for the ECO scheme, which outlines some of the carbon and cost impacts of the proposed policy changes against a business-as-usual option. Further details of this can be found below. DECC state in this updated Impact Assessment that there will be a final Impact Assessment released with the final DECC decision on the policy changes for ECO. This is because there are many current "uncertainties" around calculating the impacts of the proposed policy changes, whereas the process of consultation will allow these to be defined.

While the predominant focus of the Consultation questions sticks to the announcement made in December 2013, several of the questions mark additional concerns that DECC is consulting on. It is clear that the affordable warmth consumer group is a big priority for

DECC, as is ensuring delivery to off-gas grid areas; DECC also ask for general views on whether there should be long-term structural changes to the ECO scheme in order to help it meet its objectives more effectively.
High level details of the proposed changes are given below. Further details of the background to the changes to the ECO and Green Deal schemes, consultation questions and proposed changes, and the impact assessment, can be found below.

High-Level Details

Changes to the current ECO (ending March 2015) and the 2015-2017 phase:

- Reduction of 33% of the CERO scheme, applied to 2013-2015 phase and 2015-2017 phase.
- Processes to allow Suppliers to "bank and "carry over" more carbon for their CERO activity to make sure that the CERO cut does not disadvantage those that have delivered more.
- Process to ensure that Suppliers who have a CERO shortfall at March 2015 see their March 2017 CERO carbon target increase.
- Optimal benefits of having over-achieved against previous CERT and CESP (previous energy efficiency schemes) targets will be realised for Suppliers against their current ECO obligation.
- The bottom 25% rather than bottom 15% of areas on the Index of Multiple Deprivation will now qualify for ECO CSCO support. Suppliers can also deliver to any property located in the poorest 25% of rural areas as well as to people in rural areas who qualify under "affordable warmth" criteria in order to meet the sub-target of CSCO, the rural target. [1]
- Easy to Treat Cavity Walls and Loft Insulation are now eligible from 1 April 2014 as a primary CERO measures, along with District Heating connections.[2]
- A minimum Solid Wall Insulation target for the end of March 2017 has been proposed which cross-cuts the CSCO and CERO schemes. This will either be an equivalent of 100,000 properties (around 4MtCo2 savings) OR a requirement to treat a specific number of properties.

For the 2015-2017 phase only

- An uplifted Affordable Warmth score will apply for measures delivered to households off the gas grid (as part of the HHRCO element of ECO). In addition,

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[1] For a good summary of changes to CSCO areas, see Annex C of the Consultation: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/286930/Energy_Company_Obligation__ECO__The_Future_of_the_Energy_Company_Obligation_Consultation_DocumentFINAL.pdf

[2] For a summary of the proposals for District Heating Networks, see Annex B of the Consultation: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/286930/Energy_Company_Obligation__ECO__The_Future_of_the_Energy_Company_Obligation_Consultation_DocumentFINAL.pdf

electric storage heaters can be scored under Affordable Warmth as a "qualifying boiler receiving a higher notional saving".

- Boiler replacements under Affordable Warmth should have warranty which guarantees replacement or repair. Moreover, DECC want to encourage boiler repairs, rather than replacements, and would consider the removal or alteration of the boiler repair cap.
- The Energy Saving Advice Service will be protected as a route to ECO for Affordable Warmth households.
- Costs of delivering the next phase of the Obligation will be expected to be shared- the minimum expectation appears to be for the Suppliers to share data with DECC.

A Note on Timelines

The Consultation opened on the 5th March 2014 and will close on the 16th April 2014, so that final regulations should be laid before the Parliamentary Summer Recess if the policy making timetable runs to schedule. Changes should come into effect in October 2014 and will, where indicated, apply retrospectively.

As Ofgem cannot develop new regulations before DECC have announced their policy intentions, they will issue a "note" outlining what the interim arrangements should be for regulation between Spring and Autumn of 2014, when their new regulations can be effected.

The Consultation document makes clear that until a final decision on these proposals is made, industry should not assume that the changes outlined will apply for measures they are installing in the interim period: "The Government cannot take any responsibility for activity undertaken in reliance on these proposals in advance of final decisions being taken and the implementing legislation being made and brought into force."

Further Information

A more detailed briefing on the substance of the ECO Consultation questions and

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Background - The December Package

Following media and political interest in consumer energy bills in the autumn of 2013, the Coalition announced that they would be reviewing the policies which appeared as "green levies" on consumer energy bills in the Autumn Statement, with the intention of reducing the costs of these schemes and offering, by extension, a cut to consumer energy bills.

Approximately £112 of the average consumer energy bill each year is taken up with levies for schemes such as the Carbon Floor Price, Warm Homes, and Feed in Tariff schemes. Of this £112 around half is made up of the levy to pay for the Energy Company Obligation[3]. There were also reports from some quarters that ECO could be delivered in a more cost-effective manner. Therefore, shortly after the culmination of the "Green Levies Review", the Government announced a detailed list of cuts and revisions to ECO. It is these proposals which form the substance of the Consultation questions.

The December Package - Government Proposals

- The December package of measures, as it is now known, suggested the below changes to the Energy Company Obligation (ECO) and the Green Deal. These changes aimed to reduce the average annual consumer energy bill by £30-35 through the reduction and "streamlining" of policies which appeared as a Green Levy on energy bills. ECO represented about half of what consumers paid for such policies on energy bills.
- There are two kinds of changes being consulted upon. The first are changes to the current ECO target, both in the level of targets and the ways that they could be achieved. The second are process changes, aiming to simplify and reduce costs for both the Green Deal and ECO. In addition to the proposed revisions to policy, DECC are consulting on a range of additional incentives being introduced to encourage uptake of the Green Deal and a reduction in ECO delivery costs.

Changes to the Green Deal

- In addition to the changes announced for the ECO scheme, DECC announced a package of changes for the Green Deal which aim to both increase uptake of the Green Deal and also to offset the reduction in carbon savings that the changes proposed to ECO will cause. The aim is to ensure that these incentives encourage work carried out *additional to* work funded for the Obligation targets. DECC are interested in how this "additionality" can be ensured.

[3] Guardian, 11th October 2013, based on DECC figures.

- The DECC Impact Assessment models the same total carbon savings for the changed ECO scheme and the new Green Deal measures as were originally proposed for the ECO scheme *before* the December Announcement changes.

New Incentives

- DECC announced that the Cashback scheme (which was underspent) would be extended, and that the voucher payments for each technology would be adjusted to try to encourage uptake.
- The incentives will be targeted at either Solid Wall Insulation OR the installation of more than one measure from an approved list. In particular, the Solid Wall Insulation voucher payment will increase from £650 to over £4000.
- DECC are also considering uplifts to the new Cashback incentives for consumers who also take out Green Deal Finance, and are considering Cashback to cover the costs of the Green Deal Assessment.
- There will be a Stamp Duty Rebate worth up to £1000 (or £4000 for expensive measures such as Solid Wall Insulation) *for all housemovers* including those that don't pay stamp duty.
- The Green Deal Communities scheme has also been increased to £80m from £20m.
- A scheme for Private Landlords has been introduced. This is aiming to improve 15,000 of the least efficient rental properties over 3 years.
- There will be £30m each year for 3 years from 2014/2015, which will fund public sector improvements to buildings such as schools and hospitals.

Green Deal Finance

- DECC appear to be agnostic as to whether Green Deal Finance or private finance is the preferred route to market following a GDAR.
- The RHI and FiTs ECO streams are also eligible as part of a financial package, where applicable.
- The Government has announced streamlining processes with the Green Deal Finance Company which aim to offer a "quotation to completion in one day" service, which will bolster the other proposals.
- The Golden Rule of the Green Deal is being re-examined in order to allow consumer to potentially borrow more to finance any activity.
- DECC are considering opening the Green Deal Cashback scheme to Installers - and if so, would plan to give installers some notice of this change in order to allow them time to "gear up" for the marketing opportunity.

Impact Assessment

DECC also released a new Impact Assessment alongside the ECO Consultation, which industry and trade bodies alike will be analysing in detail over the coming days. The headline findings of the policy options consulted on, however, are as follows. DECC modelled two options: the first was "do nothing" and the second was the package of measures being consulted upon.

DECC assessed that for a "do nothing" approach to ECO the cost of delivering ECO to March 2014 would be around £1.4bn per annum - higher than consulted upon in the original Impact Assessment in 2012. This higher estimate was due to higher ECO unit delivery costs than in 2012 assumptions. Under this scenario, the modelled impacts for the next phase of ECO (2015-2017) would be lower than estimated in the original 2012 Impact Assessment "because of the market evidence on costs" and because DECC assume less potential for low-cost insulation measures to be installed.

The Impact Assessment states that fewer carbon savings will be made in the current ECO period, but that this will be achieved at a lower cost per tonne of carbon abated. DECC believe that by cutting the ECO scheme for this period, or making it more cost effective "for a given spending envelope" they will enable carbon losses to be reduced in future spending envelope periods. Overall they estimate the changes will save £30-35 off the average consumer energy bill.

The overall Net Present Value of the new-look ECO would be £2.1bn from 1 April 2014-31 March 2017 which is a reduction from the £2.6bn NPV prediction for a business-as-usual approach to the next phase. In total, the monetised benefit of continuing ECO without changes is £1.7bn PV higher than instigating the proposed changes - driven by the higher monetised value of energy savings under the original scheme.

However, DECC suggest that the proposed changes offer more potential for cost-effectiveness because the installation of "costly insulation measures" makes a business-as-usual approach around 25% more expensive than under the proposed changes (£0.7bn). The cost effectiveness in £/tCO2 for the change-nothing approach is -£56/tCO2 versus -£94/tCO2 estimated with the changes in place. This cost-effectiveness metric depends on increased blending with Green Deal Finance, however.

4.24. The figures below show the relationship between annual average ECO spend and carbon target unit savings under the CSCO and CERO under BAU and Option 2 for the period to 31 March 2017. Please note the difference in scale on the vertical axis between the two figures.

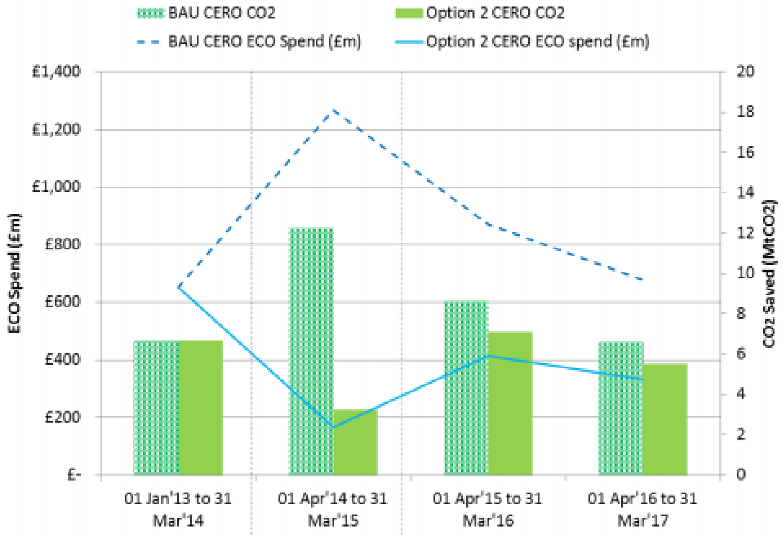

Figure 1: CERO annual spend and lifetime carbon savings under BAU and Option 2

[4]

For the package of measures as proposed by the consultation, DECC estimate that the reduced ambition for the CERO target would leave a larger amount of cost-effective technical potential for any future energy efficiency roll-out targets (including any future ECO target). They believe that this implies a greater target ambition could be achieved in the future for any given level of spend.

One clear piece of good news for industry and consumers alike is that the number of consumers now eligible for CSCO are estimated by DECC to be around 6.5million (up from 1.3million). Equally, removing the complex eligibility requirements of the Rural Safeguard sub-target means that 1.3million households could now be eligible for this portion of ECO, up from 600,000. DECC also have better oversight of the costs of identifying and administering for particular consumer groups- such as the rural target consumer segment or affordable warmth. Costs in the new IA have been modelled from real delivery data, rather than the assumed values of the 2012 impact assessment.

Solid Wall delivery is projected to be 120,000 measures installed up to the end of 2017, with 900,000 cavity wall insulation measures installed and 600,000 loft insulation measures. This is a 51% increase in the amount of cavity wall insulation installed, based on proposed changes to the CERO, and 14,000 lower SWI measures. Despite this, DECC state that in

[4] IA Pg 22
https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/286926/The_Future_of_the_Energy_Company_Obligation_Assessment_of_Impacts.pdf

reality "the market is unlikely to deliver more than the minimum [100,000]" number of SWI measures because they are "the most expensive source of abatement for Suppliers". [5]

DECC have also put significant time into modelling the impact of the ECO policy on gas/ off-gas grid households. To date, 95% of measures installed under ECO have been to gas-heated properties. Interestingly, under CERO around 10% of measures were to households on electricity but for the Affordable Warmth category less than 2% of measures went to properties heated by non-gas fuels. Therefore DECC are proposing that the changes to the ECO scheme- including uplifts for delivery to non-gas properties- will move the proportion of ECO measures reaching non-gas fuelled households up to 12%.

DECC have modelled that between 35,000 to 36,000 jobs would be supported as a result of the changes to the CERO scheme; however they acknowledge that the cut in ambition has impacted the prospective jobs market: under business as usual, ECO delivery was projected to support 42,000 to 50,000 jobs.

The economists at DECC have also looked at options for the levelisation and carry-over proposals which are aiming to "level the playing field" for Suppliers who have delivered different levels of their current targets in light of the proposed changes. More detail on this can be found in the Impact Assessment, but it is worth noting that DECC calculated the uplifts for CERO based on both primary and secondary measures and that the actual threshold and uplift will apply to savings from primary measures only. This difference is not expected to impact the mechanism.

[5] For more information on the impact of changes to CERO on SWI, see Pg 15 of the IA: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/286926/The_Future_of_the_Energy_Company_Obligation_Assessment_of_Impacts.pdf

Consultation Questions

Changes to ECO

Loft & Cavity Measures in CERO

- Reduction of the Carbon Emissions Reduction Order (CERO) element of ECO by 33% for the current Obligation. Maintaining this reduction for the 2015-2017 phase. No similar reduction will apply to either the CSCO or HHRCO elements of ECO.
- Allow loft and cavity wall insulation as eligible primary measures for meeting CERO targets. The CERO target originally prioritised more complex (and more expensive) energy efficiency measures such as hard-to-treat or solid-wall insulation (SWI).
- DECC have some concerns about the eligibility rules and compliance for loft and cavity jobs carried out under CERO as primary and secondary measures which include minimum thicknesses and area requirements[6]
- They are further interested in ways that these "easy to treat" measures could be directed away from the "able to pay" consumer market and towards affordable warmth consumers, even when being delivered to meet the CERO rather than HHRCO targets.

Solid Wall Targets

- Introduce a minimum SWI carbon target figure equivalent to 100,000 properties (around 4MtCo2) to be delivered by March 2017 to apply to CERO/CSCO. This is intended to mitigate for the likely reduction of SWI activity under CERO through the introduction of easy-to-treat measures. It is proposed that this minimum target be apportioned to Suppliers according to their market share, and that secondary measures installed alongside SWI will not be counted towards achieving any minimum target set.
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District Heating

- District Heating should be considered as eligible under CERO. District Heating projects will qualify as a primary measure as DECC are keen to prioritise the deployment of this technology and view its current status as a secondary measure as a barrier to uptake.
- District Heating measures will need to be delivered before the end of March 2015 to qualify for the current phase of ECO, and before March 2017 to qualify for the next phase.
- For a District Heating system to be eligible as a primary measure, loft and cavity insulation will have to be installed into the premises connected to the network.

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[6] P18,https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/286930/Energy_Company_Obligation__ECO__The_Future_of_the_Energy_Company_Obligation_Consultation_DocumentFINAL.pdf

Affordable Warmth & Rural Targets

- Maintaining the level of ambition for the Home Heating Carbon Reduction Order (HHCRO) and the Carbon Saving Communities Order (CSCO)
- Extend the CSCO element of ECO to apply to the 25% lowest areas on the Index of Multiple Deprivation (IMD). This is up from the bottom 15% of areas. Simplify the qualifying criteria for the rural sub-obligations of CSCO. This seeks to address the expense of identifying and verifying appropriate consumers for this part of ECO.
- For the CSCO target, the current policy about “adjoining areas” will apply. This principle is that any area that adjoins an eligible CSCO area will benefit for CSCO funding if their exclusion is otherwise marginal. This will stop, e.g. half a street of houses being eligible for CSCO funding and half being excluded if they fall either side of the 25% threshold of the IMD
- A scoring uplift will apply for non-gas fuel households treated under the Affordable Warmth element of the scheme. The aim is to ensure more of the Affordable Warmth target is delivered in the off-gas grid sector, particularly with regard to heating installations. There will be a 100% carbon uplift for non-natural gas fuelled heating measures delivered under Affordable Warmth for non-gas fuelled households, and uplifts of 5% for insulation and electric heaters.

Levelisation, Under-Delivery, and Carry Over

Current ECO Activity

- As the changes to CERO will affect the current obligation, which has already been partially delivered by Energy Suppliers, DECC are suggesting a process of “levelisation”. The theory is that those suppliers that have delivered over a certain threshold of their Obligation for CERO to March 2014 (set at 35%), will be entitled to get a carbon uplift of 1.75 times on their activity (i.e. increase the carbon score for that activity by a factor of 1.75).
- DECC’s reasoning is that if less complex measures are eligible for CERO, then CERO activity will be cheaper for Suppliers to deliver if ECO changes, and therefore those that have delivered most under previous CERO compliance standards would be put at a disadvantage.
- DECC have proposed that Suppliers will be able to carry forward a proportion of their delivery for the 2015 ECO targets to count towards 2015-2017 Obligations. They have asked about what proportion of carry-over industry feels is appropriate and whether a cap for the amount of carry over should be introduced.
- There may be an issue about how to negotiate any new “minimum level” target for Solid Wall Insulation delivery, as proposed in the consultation, if a process of “levelisation” occurs for the Suppliers’ EOCO targets. DECC suggest that they may model the “expected delivery profile” of each Supplier’s SWI activity out to March 2014 when assigning each Suppliers’ SWI target.

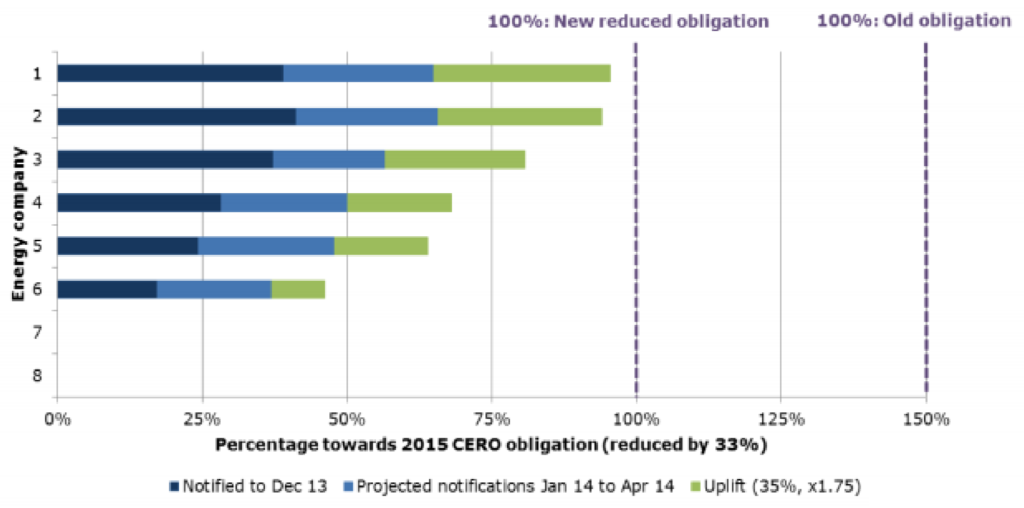
Shortfall against Targets

- To ensure continuous delivery - particularly given the gap between the announcement of the new proposals for CERO and the legislation coming into effect- DECC are suggesting that Suppliers that do not make their 2015 CERO targets will have their CERO obligation for 2015-2017 increased by adding any the shortfall, multiplied by a factor of 1.1, to the 2015-2017 phase.

CERT & CESP Excess Actions

- CERT and CESP were schemes introduced by the previous Government which between 2009 and 2012 rolled out energy efficiency measures to UK homes. As with the ECO scheme, Energy Companies were obliged to meet targets for delivery of CERT and CESP to consumers.
- It was proposed that any excess activity under CERT and CESP would be allowed to be "carried over" to count towards a Supplier's ECO delivery. DECC have amended the legislation to allow the optimal benefits from over-delivery of CERT and CESP to apply to the Suppliers' current ECO obligations. This carry-over WILL NOT be included in any calculations about ECO delivery performance, and any uplifts applied for that delivery to future ECO targets.
- Energy Suppliers who have already submitted applications for excess actions delivered under CERT and CESP under the existing provisions of ECO (pre-changes to the legislation) may be disadvantaged. Therefore DECC are minded to allow a new application deadline for notification of excess actions.

Chart 2: Impact of proposed uplift on individual companies' progress to the 2015 CERO obligation[15]



Source: Ofgem

[7]

Measures, Standards, Eligibility

Assessment Processes

- DECC are interested in whether the assessment process for measures should be recommended with the full Green Deal Assessment Report and the use of SAP/RdSAP methodology for scoring measures. They also want to views on whether there are circumstances where, for instance, a Chartered Surveyors report may be more appropriate and if these should be permitted.
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Affordable Warmth

- DECC are interested in views as to whether the consumer protection arrangements are adequate; particularly with regard to protecting Affordable Warmth consumers.
- Affordable Warmth and fuel poverty reductions are also a key target for DECC in their own right. They are consulting on routes to market for Affordable Warmth- for instance using the Green Deal Advice Report or the Energy Saving Advice Service.
- In addition, for the Affordable Warmth element of HHCRO, DECC are working with DWP and the ECO Administrator to improve access to benefits/tax credit data with customer consent. This would simplify the consumer experience and the compliance requirements for industry.

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[7] Pg. 35 https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/286930/Energy_Company_Obligation__ECO__The_Future_of_the_Energy_Company_Obligation_Consultation_DocumentFINAL.pdf

Green Deal Installers

- DECC have proposed that if GDARs become the route for assessing ECO delivery in every case, that all ECO measures eventually be undertaken by accredited Green Deal installers- while also maintaining the PAS 2030 requirement.

Boilers

- Boiler replacements are of particular interest to the DECC team, and they are proposing that boiler replacements include a warranty with a minimum length of cover for parts and labour that would provide for actual repair/replacement rather than compensation. In addition they are concerned about the "effectiveness" of Ofgem's Boiler Assessment Checklist for determining the standards of a "qualifying boiler" for ECO.
- DECC also have some concerns around the definition of "qualifying boiler" and a perceived preferential skew towards the gas market. There are questions in the consultation about changing the baseline heating technology used to calculate Affordable Warmth "qualifying boiler" scores and DECC are also proposing that electric heaters should be scored as "qualifying boilers"
- DECC wish to promote "repair" rather than replacement for boilers, and ensuring that the most appropriate or economically sensible solution is the one chosen. They argue that there may be a case for removing or changing the current cap on boiler repairs undertaken.
- DECC wish the costs of ECO delivery to be more "transparent". They are consulting on taking powers to ensure obligated parties disclose information over costs at the appropriate time.

Finance (Blending, Brokerage, Green Deal)

Blending

- The Government views blended financial packages as critical to the success of ECO.
- They propose not to regulate blended financial packages into existence but wish to reserve this as an option should the market fail to deliver still. If introduced, this would require at least the equivalent of 1000 Green Deal plans a week to be achieved through blending.
- In addition to the ability to introduce blending through legislative powers, DECC are interested in views on whether providing an ECO "bonus" or "uplift" for delivering activity through blended finance would be a driver for this kind of arrangement.
- Affordable Warmth remains a priority interest for DECC, and any future legislation to, for instance, encourage more blended finance would have to take into consideration the impacts this could have on fuel poor consumers. Therefore, there are questions in the consultation about how Affordable Warmth measures delivered

under ECO could include customer contributions, and whether limits should be applied.

Brokerage

- The changes proposed could impact the current trading under Brokerage. Therefore DECC wish to understand whether the Government should regulate to mandate participation in brokerage, or obligate Suppliers to deliver a portion of their ECO activity through Brokerage.

Green Deal

- DECC appear to be agnostic as to whether Green Deal Finance or private finance is the preferred route to market.
- The RHI and FiTs ECO streams are also eligible as part of a financial package, where applicable.
- The Government has already announced streamlining processes with the Green Deal Finance company which are aiming to offer a "quotation to completion in one day" service, which will bolster the other proposals.
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